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Statement of Rep. Christopher Shays
Committee on Oversight and Government Reform
"The Causes and Effects of the AIG Bailout"
October 7, 2008

Thank you, Mr. Chairman. Today we consider the case of the American International Group (AIG), a global insurance conglomerate saved from insolvency by an $85 billion loan from American taxpayers. As part of the deal, we own a controlling stake in the company. In these bailouts, the United States Treasury is now in the business of picking winners and losers as the global economy struggles to purge the toxins of speculative greed polluting capitalism's bloodstream. We need to understand what makes a private company like AIG "too big to fail" and what drew such a large and venerable enterprise to the brink of failure.

In the search for causes, all roads lead to the housing market dominated by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Without question, mortgage-backed assets – sliced and diced and scattered throughout the financial system – lie at the epicenter of the economic earthquake shaking world markets. Ripples from defaults on subprime loans underwritten by Fannie and Freddie grew to a tsunami that helped swamp Lehman Brothers and others, including AIG. And Fannie and Freddie were able to launch more than $1 trillion of bad paper into the private market because regulators, and Congress, let them do it. The Committee cannot conduct a credible examination of the current crisis without focusing on the market-distorting power of the federal mortgage giants and the firewall against reform manned by their enablers here in Congress.

No one is disputing the Committee's focus on executive pay. We agree company compensation is a telling indicator of a corporate culture detached from larger market realities and the fundamental fiduciary duty to be frugal stewards of other people's money. And that "me first" self-indulgence was just as rampant at Fannie Mae as at its private sector partners and competitors. From 1998 to 2003, Fannie Mae CEO Franklin Raines alone took over $90 million in salary and bonuses. The Raines team was even caught manipulating accounting practices to overstate profitability so they could grab what their overseer called "ill-gotten bonuses in the hundreds of millions of dollars." The Fannie Mae board gave recently-ousted CEO Daniel Mudd a $2.6 million bonus in 2005, on top of his $3.5 million salary, based on a set of "non-financial" goals such as promoting "respectful, appropriate and productive" relationships with regulators.

In the context of a $6 trillion mortgage securities portfolio, those paydays may seem like small change, but it's indicative of a prevalent and noxious rot that threatens the moral underpinnings of the entire capitalist business model.

So we need to keep the toxic twins, Fannie and Freddie, at the center of this investigation. Yesterday, we sent a formal request to the Chairman asking for a specific commitment to make the federal mortgage companies a priority in these hearings, not an afterthought. We can't wait until Halloween to unmask these two failed monsters of mortgage finance.

As for AIG, I am interested in learning more about the corporate decision making that took a solid insurance business into the far less stable world of credit default swaps and other exotic derivatives. They thought they were selling insurance when in fact they were betting the company's soul in a high-stakes game of Russian roulette. We need to ask what AIG knew about the risks behind these novel products, when they knew the bet soured, and how they informed investors, policy holders, regulators and the public that the company was in peril.

AIG, like Fannie Mae and Freddie Mac, was considered too big to fail. Going forward, we need to grapple with the implications of the concept government will be there to break the fall of some large business, but not others. It's been said capitalism without failure is like religion without sin. Any doctrine loses its moral authority when bad conduct is rewarded and the consequences of poor choices are foisted on someone else. Investigating the causes and effects of this financial debacle should involve assigning culpability and restoring integrity, and balance, to the system of risks, rewards and penalties our society uses to assign value to labor, capital and commerce.